DEPARTMENT OF CORPORATIONS.

EDITOR-IN-CHIEF,
ANGELO T. FREEDLEY,
Assisted by
LEWIS LAWRENCE SMITH, CLINTON ROGERS WOODRUFF,
MAURICE G. BELKNAP, H. BOVEE SCHERMERHORN.

DEWEY ET AL. *v.* TOLEDO, A. A. & N. M. RY. CO.[1] SUPREME COURT OF MICHIGAN.

The purchase by a railroad company of stock in another company whose line is not parallel, for the purpose of acquiring the latter's right of way, is valid under How. (Mich.) Stat., § 3403, authorizing any railroad company which had in good faith entered upon the construction of its road and become unable to complete the same, to sell the road and its rights and franchises to any other railroad company not having the same terminal points and not being a competing line.

THE POWER OF ONE RAILROAD COMPANY TO PURCHASE STOCK IN ANOTHER.

The rapid tendency towards consolidation of smaller railroad companies into great systems, now progressing in the United States, makes the question of the legality of a course not unfrequently practiced for such a purpose, one of much interest.

A corporation is a creature of the Act of Incorporation and as such has no other powers than are expressly granted or are necessary to effect the ends and objects of its existence. The charter being a contract between the public and individuals must be strictly construed. Each right the corporation possesses need not be specially enumerated, but no authority can be inferred other than for purposes directly conferred: The New Orleans, etc., Co. *v.* Dock Co., 28 La. Ann. 173; Franklin *v.* Lewiston Institution for Savings, 68 Me. 43.

[1] Reported in 51 N. W. Rep. 1063.

The right of a railroad company over its funds cannot be construed according to the rules applicable to literary, scientific and religious corporations. Such corporations require authority to invest their money in order to maintain themselves and preserve whatever may be given them. In such charters the power, if not expressly mentioned, is implied, that they may successfully engage in the enterprises for which they are organized and render what funds they have productive.

At common law the directors of one railroad company have no authority to invest their capital or profits in the stock of another. Railroad corporations are chartered to transport passengers or merchandise, and are bound to apply all the monies and property of the company for that purpose. Investing their funds in that of other corporations is not within the scope of the business for which they are incorporated: Munsell *v.* Midland, etc., R. R. Co. (1863), 1 H. & M. 130; Woods *v.* Memphis, etc., R. R. Co., 5 Ry. & Corp. L. J. 372; Hazelhurst *v.* The Savannah, etc., R. R. Co., 43 Ga. 13; Haver *v.* New York, etc., R. R. Co., 19 Abb. N. Cas. 456; MacIntosh *v.* Flint, etc., R. R. Co., 34 Fed. Rep. 582; The Central, etc., R. R. Co. *v.* The Penna. R. R. Co., 36 N. J. Eq. 475; Solomens *v.* Laing, 12 Beav. 339; The Great Northern Ry. Co. *v.* The Great Eastern Counties Ry. Co., 21 L. J. Ch. 837; The New Orleans, etc., Steamship Co. *v.* Ocean Dry Dock Co., 28 La. Ann. 173; The Great Western Ry. Co. *v.* The Metropolitan Ry. Co., 32 L. J. Ch. 382; Milbank *v.* New York, etc., R. R. Co., 64 How. Pr. 20.

"Every charter of a private corporation is a contract, first between the State and the corporation—to which each is solemnly bound—the State that it will not impair the obligation—the corporation that it will perform the objects of its corporation and keep within the powers granted to it; secondly, between the stockholders themselves. The stockholders are bound to consent to the management of the affairs of the corporation by the majority, and by the by-laws which the majority makes. And the whole on the other hand agree with each other that they will apply the funds of the company to the

objects and purposes of the charter and not otherwise. Both as between the State and the corporators, the law of this contract is the charter. The State has granted to it no rights and the individual stockholders have clothed it with no rights, except such as are clearly and expressly set down in the charter: Central R. R. Co. *v.* Collins, 40 Ga. 582.

State constitutions sometimes contain express prohibitions against the purchase of stock in other roads. On the other hand, single companies are occasionally authorized to do so by their charters and in other instances, general law; Zabriskie *v.* R. R. Co., 23 How. (U. S.) 381; or special Acts; Mayor of Balto. *v.* Balto., etc., R. R. Co., 21 Md. 50; confer the power.

If one railroad company may, at its option, buy the stock of another it undertakes a new contract not contemplated by its charter: Hazelhurst *v.* The Savannah, etc., R. R. Co., 43 Ga. 13.

It is no answer that the action of the directors is of benefit or profit to the shareholder seeking to prevent the purchase. Whether it is to his interest, is for him to judge. He has a legal right to insist that the company shall be kept within the legitimate scope of the charter: Elkins *v.* Camden, etc., R. R. Co., 36 N. J. Eq. 5; Central R. R. Co. *v.* Collins, 40 Ga. 582.

Power expressly granted to a railroad company to maintain the road does not authorize a purchase of stock in a rival road because such purchase is necessary to its self preservation.

The Central Railroad Company was given by its charter power to "have, purchase, receive, possess, enjoy and retain to them and their successors, lands, rents, tenements, goods, chattels and effects, of whatsover kind, nature and quality, the same may be, and to sell, grant, demise, alien or dispose of the same." It was argued that such an indefinite grant authorized them to purchase and hold any kind of property necessary to protect the road, and was not precluded such a construction by a proviso restricting the power to such lands as it might acquire in satisfaction of debts and such as might be necessary and proper for laying, building and sustaining the railroad. In reply it was said by the court, "To give these words the meaning contended for would be to make the Central Railroad

and Banking Company a corporation for any purpose whatever. It might engage in whatever enterprise that the cupidity of its directors or their fancy or folly might suggest to them."

"What does a grant to maintain and sustain a railroad include? Can it in any fair sense be construed to authorize the engaging in any other enterprise which will extend the business or lessen the rivalries of the company. The 'maintaining and sustaining' of the road has reference to keeping it in repairs, supplying it with machinery and such like acts and not to projects for extending its business, by schemes and enterprises not contemplated and expressed in clear, unambiguous terms by the charter itself:" Central R. R. Co. *v.* Collins, 40 Ga. 582. See *contra:* Ryan *v.* The Leavenworth, etc., R. R. Co., 21 Kan. 365; Atchison, etc., R. R. Co. *v.* Cochran, 43 Kan. 225. See, however: Penna. R. R. Co. *v.* Com., 7 Atl. Rep. 368.

The General Railroad Laws of Michigan provide that one railroad corporation may subscribe to the capital stock of any other railroad company organized under the said Act with the consent of the latter; and by other provisions, one railroad company is authorized to aid another having an unfinished road, and to make running arrangements; and where their lines are connected to enter into arrangements for their common benefit, consistent with and calculated to promote the objects for which they were respectively created. In MacIntosh *v.* Flint, etc., R. R. Co., 34 Fed. Rep. 582, it was decided that these statutory provisions did not authorize one company to acquire the stock and franchise of another completed company.

A company having authority to purchase a limited number of shares in another cannot increase its holding: Solomens *v.* Laing (1849), 12 Beav. 339; The Great Western Ry. Co. *v.* The Metropolitan Ry. Co., 32 L. J. Ch. 382.

Since chancery will enjoin acts of this character, so will it decline to lend its aid where, by so doing, it would give effect to them: The Great Northern Ry. Co. *v.* The Great Eastern Counties R. R. Co., 21 L. J. Ch. 837; The Great Western Ry. Co. *v.* The Met. Ry. Co., 32 L. J. Ch. 382. In this latter case the company had been authorized by Parliament to hold

a stated number of shares in another road. The directors of this road decided to increase the number of shares, but refused to make any allotment to the other company as shareholder. A bill in equity was filed to compel an award of the proportion which their shares entitled them. In dismissing the bill, Lord Justice Turner, one of the court, observed, while they were not entitled to receive and hold the additional shares, yet had the bill averred an intention to dispose of their allotment and prayed that it be made in order that the benefit to be derived from their sale might be secured to the company, such question would be worthy of much consideration.

The purchase of stock in a parallel and competing line was held to be prohibited by the Constitution of Pennsylvania which provided: "No railroad . . or the lessees, purchasers or managers of any railroad . . . shall consolidate the stock, property or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad owning or having under its control a parallel or competing line: Penna. R. R. Co. *v.* The Commonwealth (Pa.), 7 Atl. Rep. 368.

The right to lease does not give the right to buy a road or become the purchaser of its stock: Central R. R. Co. *v.* Collins, 40 Ga. 582.

By the General Railroad Laws of New Jersey (Rev. p. 730, § 17), and the Act of 1880 (P. L. 1880, p. 231), power was given to railroad companies to lease their roads or any part of them to any other corporation or corporations of that or any other State, or to unite or consolidate as well as merge their stock, property and franchises and roads with those of any other company or companies, and it was further provided that the company acquiring the other road might use and operate both or either of the roads.

The Camden and Atlantic Railroad on the strength of these statutory privileges attempted to purchase the majority of the stock and bonds of a rival road, and assume control of certain of its debts. A bill in equity was brought to prevent such purchase. In sustaining the injunction it was said by the Supreme Court: The Acts of the Legislature while

they gave the Camden and Atlantic Railroad power to unite and consolidate with other roads, it gave it no power to purchase the debts of another company or its road. Union and consolidation of two rival railroad companies are one thing and purchase by one company of the property and franchises of the other is another. Such purchase is foreign to the object of its incorporation. The power to build lateral or branch roads given by the charter, was not considered to strenghthen the contended construction: Elkins *v.* Camden, etc., R. R. Co., 36 N. J. Eq. 5.

Although the company may have authority by the law of the State where it originated, yet it cannot purchase the stock of a road in another State, unless expressly authorized so to do by local legislation: Woods *v.* The Memphis, etc., R. R. Co. (Ala.), 5 Ry. & Corp. L. J. 372.

A State cannot by an Act subsequent to the charter, confer the power on a railroad to invest its fund in the bonds or stock of another: Central R. R. Co. *v.* Collins, 40 Ga. 582; White *v.* The Syracuse, etc., R. R. Co., 14 Barb. (N. Y.) 559.

By the Act of 1852, of Georgia, the Central Railroad Company was given power to lease several railroads by name as well as any other road that might "connect" with it, and by a subsequent Act authority was given to connect their tracks at the city of Savannah.

In the opinion of the Supreme Court it was held that, "any such power, though expressly granted, does not bind any of the stockholders who do not consent to it. Each stockholder has rights in the nature of contract, rights in the limitations as well as in the grants to the corporation, and even the legislative will cannot under the Constitution of the United States impair those contract rights, by making him against his will an adventurer in an enterprise not contemplated in the original charter: See also White *v.* The Syracuse, etc., R. R. Co., 14 Barb. (N. Y.) 559.

If the Legislature has reserved to itself the right to alter the charter of the company, the proper number of shareholders may take advantage of a subsequent Act, authorizing a purchase of stock in another company, by the consent of a certain

number of shareholders: White *v.* The Syracuse, etc., R. R. Co. (1853), 14 Barb. (N. Y.) 559.

Where no power has been reserved to the State to sanction such a use of corporate funds, a stockholder may sometimes, by his failure to object at the proper time, estop himself from afterwards complaining: MacIntosh *v.* Flint, etc., R. R. Co., 34 Fed. Rep. 582.

In Zabriskie *v.* The Cleveland, etc., R. R. Co., 23 How. (U. S.) 381, the complainant, who was a stockholder in the defendant company, was present by proxy at a meeting at which it was agreed to guarantee the bonds of another company. No objection was made in his behalf. It was held he could not complain after some of the guaranteed bonds had been sold.

So, in Hill et al. *v.* Nisbet et al., 100 Ind. 341, persons who constituted a majority of the directors, when the purchase of stock was made, were held to have no standing in equity to question the validity of such purchase.

It is possible that a right of action which might arise out of the relations of such companies could not be enforced: Thomas *v.* R. R. Co., 101 U. S. 71.

Should all the shareholders unite and authorize the use of the company's funds for the purchase of stock in another road, the State may, at any time, interfere and compel its sale or deprive the company of its charter: Mathews *v.* Murchison (U. S. C. C., N. Car., E. Dist.), 9 Am. & Eng. R. R. Cas. 590.

A shareholder in a company, whose stock has been bought by a rival company, can enjoin the rival company from voting on the shares held by it at a meeting of his company: Pearson *v.* Railroad (1883), 62 N. H. 537.

And this rule is equally applicable, if not stronger, where the power to vote has alone been purchased: Woods *v.* The Memphis, etc., R. R. Co. (Ala.), 5 Ry. & Corp. L. J. 372; Haven *v.* New York, etc., R. R. Co., 19 Abb. N. Cas. 456. See *contra:* Mathews *v.* Murchison, 9 Am. & Eng. R. R. Cas. 590.

But such stockholders cannot complain because of the mere taking title to and holding of the stock and the collection of

dividends as they may accrue. It is only where the company seeks to vote upon the stock and thereby control the corporation that they are prejudiced: Milbank *v.* New York, etc., R. R. Co., 64 How. Pr. 20.

State statutes have in several instances been declared to empower a railroad corporation to hold the stock of another: Zabriskie *v.* R. R. Co., 23 How. (U. S.) 381.

Section 3951, R. S. 1881 of Indiana, authorizes any railroad corporation organized, under the provisions of the general railroad law, "to acquire, by purchase or contract, the road, the road-bed, real and personal property, rights and franchises of any other railroad corporation or corporations which may cross or intersect its line. In Hill et al. *v.* Nisbet et al., 100 Ind. 341, this provision was regarded as sufficiently broad to empower a purchase of stock in an intersecting road. Mr. Justice Mitchell, speaking for the court, said: "If in any case it should appear to be a necessary or reasonable means to acquire the franchise of an intersecting railroad company, and by the averments in the complaint, the purpose for which the stock was purchased may be fairly inferred, no reason is perceived why it might not be accomplished by purchasing the stock instead of purchasing the corporate property directly."

Where extraordinary circumstances arise the common law rule may not be enforced. A railroad company may, without express authority, acquire stock in another corporation in satisfaction of a debt or by way of security for a claim which is in danger of being lost, but with a view to its subsequent sale or conversion into money so as to make good or redeem an anticipated loss: Hodges *v.* New England Screw Co., 1 R. I. 312; Pierson *v.* R. R., 62 N. H. 537; Woods *v.* The Memphis, etc., R. R. Co. (Ala.), 5 Ry. & Corp. L. J. 372; Milbank *v.* New York, etc., R. R. Co., 64 How. Pr. 20.

Having obtained the stock it may collect the dividends: Woods *v.* Memphis, etc., R. R. Co. (Ala.), 5 Ry. & Corp. L. J. 372; Milbank *v.* New York, etc., R. R. Co., 64 How. Pr. 20.

In Elkins *v.* R. R. Co., 36 N. J. Eq. 233, a shareholder filed a bill in equity to prevent the sale of 800 shares of stock

of another railroad, claiming that by so doing they would depreciate their road and deprive it of its influence in the other company. The stock had been obtained in exchange for iron rails which they had ceased to use. It appeared the directors, believing it to be for the benefit of their road, had authorized the sale to be made by their president at a price shown to be its market value by a public sale of part of it. The court declined to interfere.

A corporation cannot, by a simulated compliance with the provisions of the law, subscribe for stock through its agents or employés. In the case of the Central R. R. Co. *v.* The Penna. R. R. Co., 36 N. J. Eq. 475, the National Storage Company, incorporated under the laws of New Jersey, was restrained from laying its tracks across the land and tracks of the Central Railroad Company of New Jersey, because it appeared that the capital stock of the storage company was held in trust for persons owning large interests or largely concerned in the management of the Pennsylvania Railroad Company.

Where the *ultra vires* Act is as yet only in contemplation, t has been urged to induce a court of equity to act, the complainant should show he would sustain irreparable injury. But the courts have answered that they will restrain such an act although it appear to be of material advantage to him: Central R. R. Co. *v.* Collins, 40 Ga. 582; Elkins *v.* Camden, etc., R. R. Co., 36 N. J. Eq. 5. Thus the directors may be restrained from borrowing money for an anticipated purchase.

Public policy is often cited as declaring the annihilation of the lesser lines as an evil. That it will result in good is claimed by those desiring to bring the condition about. It was said by the president of one of our trans-continental railroads: "The crystallization of small and local lines, and the absorbtion of branch roads is viewed with grave popular apprehension, but I cannot regard it as a thing to be dreaded. I am very sure now, as I have been for the last twenty years, and as I long ago expressed myself, that a great consolidated corporation or even a trust can be held to far stricter

responsibility of the law than numerous smaller and conflicting corporations:" Cook on Stockholders, § 315, note.

Where the power to make a contract for the purchase of stock in another companies is granted in the charter, the public policy of such a grant is not a consideration for the court. It has been said, however, where no such privilege exists, that public policy furnishes an additional reason for the application of the rules of strict construction.

In the Central R. R. Co. *v.* Collins, 40 Ga. 582, it was said by the court: "All experience has shown that large accumulation of property in hands likely to keep it intact for a long period, are dangerous to the public weal. Having perpetual succession, any kind of a corporation has peculiar facilities for such accumulation and most governments have found it necessary to exercise great caution in their grants of corporate powers. Freed, as such bodies are, from the sure bound to the schemes of individuals—the grave—they are able to add field to field and power to power, until they become too strong for that society which is made up of those whose plans are limited by a single life."

"There is, too, in this country, a reason for strictly construing charters and for confining corporations to their powers that do not exist in any others. Under other forms of government if a charter be found to have privileges which prove dangerous, it is in the power of the State to alter or repeal the charter. But getting their grants as most of our corporations do from the State they are held to be contracts, and it is not in the power of the State, under the Constitution of the United States, to materially interfere with the grant however improvident or unwise it may prove to have been. For these reasons it has in this country, as well as in England, ever been considered the very highest public policy to keep a strict watch upon corporations, to confine them within their appointed bounds, and especially to guard against the accumulation of large interests under their control."

Again, in Milbank *v.* New York, etc., R. R. Co., 64 How. Pr. 20, Haight, J., said: "It is against public policy to permit the officers of a corporation to take the corporate funds

belonging to the stockholders and expend it in purchasing or speculating in stocks of other companies. In the second place, it is against public policy to have or permit one corporation to embarrass and control another and perhaps competing corporation in the management of its affairs.

Equitable relief will be granted at the instance of a single shareholder: Elkins *v.* Camden, etc., R. R. Co., 36 N. J. Eq. 5; Solomens *v.* Laing, 12 Beav. 339; Central R. R. Co. *v.* Collins, 40 Ga. 582.

Nor does it matter that the shareholder asking relief acquired his stock for the purpose of defeating an intended purchase. Where an Act is *ultra vires* the relief cannot be affected by such circumstances: Elkins *v.* Camden, etc., R. R. Co., 36 N. J. Eq. 5.

A State as shareholder may bring the action, but citizens in their character as such are not proper parties: Central R. R. Co. *v.* Collins, 40 Ga. 582; Woods *v.* Ry. Co., 5 Ry. & Corp. L. J. 372.

Before invoking the arm of chancery it is necessary in general to give the stockholder a standing in court that the directors be requested to refrain from a contemplated violation or remedy an existing one, but this is not always necessary. It has been said, "the whole governing force may have become so corrupt or have entered into a combination so destructive of the policy and property of the company as to show that an appeal to the directory would be fruitless and delay extremely perilous. In such cases, an application to the directors would be without avail and equity will take jurisdiction:" Woods *v.* Memphis, etc., R. R. Co. (Ala.), 5 Ry. & Corp. L. J. 372 (Cobb's Chan.).

Where the directors have violated the charter of their company it becomes a question how far they are personally responsible to refund money so applied. The liability has been said to depend on whether the violation was a mistake such as a man of ordinary prudence exercises in his own affairs. In Hodges *v.* New England Screw Co., 1 R. I. 312, it was said: "If the mistake was such as, with proper care, might have been avoided they ought to be liable. If, on the other hand, the

mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the company they ought not to be liable. If the innocent mistakes of directors in cases where the law was unsettled or unknown, is to subject them to damages, great injustice would be done. The law requires of them care and discretion such as a man of ordinary prudence exercises in his own affairs; and if they practice this and, nevertheless, make a mistake the law does not hold them answerable."

It would seem however that the liability of directors might more properly be regarded as the liability of trustees, and that they would only be protected by first taking the advice of counsel: Augell &. Ames on Corp., § 392.

MAURICE G. BELKNAP.

NOTES AND COMMENTS ON RECENT DECISIONS.

The following is a judgment in the Quarter Sessions, for obvious reasons we think it better to omit the name of the county and judge.

The defendant had in his possession packages of oleomargarine which came to him from another State as an article of merchandise and have remained in that condition unopened.

Is he liable to be convicted of a misdemeanor because he has sold them in the same condition, that is unopened?

The court in passing on this question is in somewhat of a dilemma.

Oleomargarine is a product of material taken from the carcasses of neat cattle. It was invented at the instance of the French Government for the use of their armies in hot climates, and the chief consumer at present is Holland from which the world receives and consumes it as food in the form of butter and cheese. No one has as a matter of fact ever doubted that it is a perfectly wholesome article of food—it is